DEPARTMENT OF CONSUMER & INDUSTRY SERVICES

OFFICE OF FINANCIAL AND INSURANCE SERVICES

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Frank M. Fitzgerald
Commissioner of Financial and Insurance Services

REPORT OF EXAMINATION OF

BLUE CROSS AND BLUE SHIELD
OF MICHIGAN
Detroit, Michigan

As of September 30, 2000

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In accordance with Section 222 of the Michigan Insurance Code, the Office of Financial and Insurance Services produced 300 copies of this report at a total cost of $298.15 or approximately $.99 each. This cost is funded by assessment fees charged to the insurance companies.

Mr. Frank M. Fitzgerald
Commissioner of Financial
and Insurance Services
State of Michigan
Lansing, Michigan 48909

Commissioner:

In accordance with instructions and statutory requirements, we have conducted an examination of the financial condition, management and operations of

Blue Cross and Blue Shield of Michigan
Detroit, Michigan

a nonprofit hospital and medical plan, hereinafter referred to as the "Company." Our examination report follows.

SCOPE OF EXAMINATION

The Office of Financial and Insurance Services (OFIS) conducted an examination of the Company for the period from January 1, 1998 through September 30, 2000. We hired the accounting firm of PricewaterhouseCoopers LLP to assist us in our examination. We conducted the examination in accordance with generally accepted auditing standards. In addition, we determined compliance with P.A. 350 of 1980 and the laws, regulations and rules prescribed by OFIS. We conducted a concurrent examination of the Company's wholly-owned subsidiary, BCN of Michigan.

We reviewed and incorporated certain workpapers of the Company's independent auditors, Deloitte & Touche LLP, into our examination workpapers, where appropriate.

To determine the adequacy of the Company's unpaid claims reserves and related actuarial items, we hired the actuarial consulting services of PricewaterhouseCoopers LLP. The analysis was performed by Martin E. Staehlin, FSA, MAAA. The analysis consisted of the tests necessary to certify the adequacy of the unpaid claims reserves and related actuarial items. The actuarial certification of PricewaterhouseCoopers LLP is attached to this report of examination as Exhibit 1. The firm's detailed actuarial reports are on file at our offices.

The Company's assets were verified and liabilities determined as of September 30, 2000 except for federal income taxes and benefit plan related amounts which were examined as of December 31, 2000. We performed a limited review of the intervening years between the last examination and this September 30, 2000 examination. This review consisted of detailed substantive testing of select balances, analytical review of the changes in the balance sheet and a review of the minutes of the board of directors and annual meeting of the incorporators.

The overall examination strategy was to test at a high control reliance. As such, our testing included evaluation and testing of the information systems controls and documentation and testing of the internal control systems for selected business cycles.

Information Systems Testing Approach

Testing of the Company's information systems was completed through the utilization of the National Association of Insurance Commissioner's ("NAIC") Evaluation of Controls in the Information System Questionnaire ("ISQ"). The ISQ and testing guidance from the NAIC requires certain tests to be performed depending upon the systems and controls in place at the Company. Each section of the ISQ contains several suggested controls the examiner should test based upon the subject covered in the section. The ISQ also prescribes the testing that should generally be performed to assess each control.

While conducting the exam, we used four types of testing suggested by the ISQ which included management controls, organizational controls, changes to applications and system and program development. Testing included tests of inquiry, inspection, observation and re-performance of procedures previously conducted by management. Examples of inquiry tests included discussions with management to verify procedures, to identify appropriateness of user and programmer access to critical files and to confirm management strategy. Tests of inspections included the reading and assessment of documentation or other physical evidence that a control is in place. Tests of observation included reviewing reports and systems to test whether described procedures and controls were actually functioning in the production environment, for example, observing a list of terminated users to determine whether the users have been physically removed from the system. Finally, re-performance of procedures was used to verify that monitoring procedures performed by auditors or managers were appropriate.

Financial Audit Approach

Testing of the Company's financial balances was completed through the documentation and testing of related internal control systems as well as detailed testing of selected account balances. We utilized the Specific Risk Assessment forms ("SRA's") to assist in documenting and evaluating the Company's control environment and to determine appropriate reliance to be placed upon the respective system. SRA's completed during the examination included the premiums cycle; losses and benefits cycle; investment cycle; administrative cycle; fixed asset cycle; salary, wages and employee benefits cycle; financial reporting cycle; and borrowed money and surplus cycle. Testing included tests of inquiry, inspection and re-performance of procedures previously performed by various Company personnel.

A high control reliance was placed on the premiums and losses cycles. Additional detailed substantive testing, in conjunction with analytical procedures, was completed for all significant account balances as deemed necessary. Testing included obtaining and analyzing account reconciliations and related schedules prepared by the Company, independent confirmation of balances with third parties, agreement of selected amounts to supporting documentation and vouching amounts to underlying documentation including check receipts, check payments, invoices, etc.

An overview of the procedures completed during this examination for cash and investments, federal income taxes and certain actuarially determined assets and liabilities included, but were not limited to, the following:

We obtained and tested the respective cash and investments reconciliations which included independent confirmation, detailed testing of selected reconciling items, valuation analysis and review the Company's compliance with various regulatory provisions. Cash and investments (bonds and stocks) represent 35% of total assets.

The Company, as well as other Blue Cross entities, are subject to certain specific sections of the Internal Revenue Code. The Company prepared its Federal income tax provision and deferred tax analysis as of December 31, 2000. Examination team members with appropriate experience with these tax code provisions assessed the reasonableness of the Company's Federal income tax payable, deferred tax bases differences and related provisions.

To test and evaluate the reasonableness of certain actuarially determined assets and liabilities including unpaid claims, rate stabilization receivable, provision for experience rating refunds, advances to providers, provider settlements and pension and other post-retirement liabilities appropriate actuarial analyses were completed. The actuarial analysis included reviewing methodologies and assumptions used by the Company, as well as those used by their consulting actuaries. There was significant emphasis placed on evaluating the recoverability of the rate stabilization receivable. We expanded the Company's analyses to further model trends by product and by area. The testing of these assets and liabilities required significant analysis and support by experienced healthcare actuarial members of the examination team.

We also tested the underlying data provided to the actuaries supporting these account analysis. Testing included but was not limited to the following: Claims data was reconciled to systems reports and respective general ledger accounts. Various tests were performed on provider data, including confirmation of selected information with providers, review of certain settlement reports/correspondence and sample testing of provider claims and 'BIP' payments. As the most significant rebate relates to prescriptions, on a sample basis we tested the allocation of the rebate to each of the respective groups, including 'ASA', experience rated, area rated, etc.

The following matters were also reviewed:

Conflict of Interest
Fidelity Bonds and Other Insurance
Advertising
Accounts and Records
Complaints

In addition, transactions occurring subsequent to September 30, 2000 were reviewed, where deemed advisable. Comment on the findings of our examination is limited to matters involving a departure from laws, rules or regulations; a significant change in the amount of an item; or where an explanation, comment and/or recommendation is deemed warranted. Any other adjustments or comments were discussed with Company personnel and may appear in a letter to management which was prepared in conjunction with this report of examination.

HISTORY AND PURPOSE

The Michigan Hospital Service (Blue Cross) was incorporated on October 3, 1938, as the Michigan Society for Group Hospitalization, a nonprofit corporation, under the provisions of Act 327 of the Michigan Public Acts of 1931, known as the Michigan General Corporations Act. The Michigan Society for Group Hospitalization was authorized to transact business on December 8, 1938.

In 1939, the society became subject to the provisions of Act 109 of the Michigan Public Acts of 1939. On July 12, 1940, the name of the society was changed to Michigan Hospital Service.

The Michigan Medical Service (Blue Shield), under the sponsorship of the Michigan Medical Society, was incorporated on August 1, 1939, under the provisions of Act 108 of the Michigan Public Acts of 1939. Michigan Medical Service commenced business on March 1, 1940. The name of the corporation was changed in 1973 to Blue Shield of Michigan.

On February 1, 1975, the Michigan Hospital Service and Blue Shield of Michigan consolidated to form the corporation of Blue Cross and Blue Shield of Michigan under a plan of consolidation filed pursuant to Acts 331 and 332 of the Michigan Public Acts of 1974.

The purpose of the Company is to carry out the objectives of the plan of consolidation and to exercise all the powers of a medical care corporation organized under Act 108 of the Michigan Public Acts of 1939, as amended and of a hospital service corporation organized under provisions of Act 109 of the Michigan Public Acts of 1939, as amended.

On October 30, 1996, the board of directors adopted the following revised Corporate Mission Statement:

> "The mission of Blue Cross and Blue Shield of Michigan is to excel in the delivery of health care related products and services that emphasize access to quality health care at affordable prices. We are committed to meeting our public responsibilities and maintaining our not-for-profit status. Other essential components of the corporation's mission statement are:
>
> ™ To develop new approaches to the challenge of assuring all citizens of Michigan access to reasonably priced, quality health care.
>
> ™ To assure older and disabled citizens that supplemental coverage will always be available to group and nongroup Medicare enrollees.
>
> ™ To work actively as a committed partner with business, providers of care, organized labor, state government and groups representing older people and subscribers to solve specific health care problems.
>
> ™ To operate efficiently and to represent fairly the interests of program beneficiaries in the role of administrator of government-sponsored health programs.
>
> ™ To cultivate with physicians, hospitals, and other providers, relationships characterized by mutual respect, trust, confidence, and a shared interest in the welfare of the people of the state of Michigan to improve and enhance the overall delivery of health care.
>
> ™ To design and administer competitive, quality, cost effective health care benefit programs and to provide superior service to all customers, subscribers and providers.
>
> ™ To strive to succeed as a business enterprise in order to fulfill the other aspects of the mission."

The term of existence of the Company is in perpetuity.

MANAGEMENT AND CONTROL

Organizational Structure

The Company is a consolidated corporation authorized to perform those items set forth in Section 202(1)(d) of P.A. 350 of 1980. The organizational structure is shown as Exhibit 2. The following is a brief overview of the Company's subsidiaries as of September 30, 2000:

BCN Management Company

BCN Management Company is a wholly-owned subsidiary of the Company and was formed in 1991. BCN Management Company serves as management oversight over BCN of Michigan HMO and Blue Care, Inc. The management oversight functions include general policy guidelines, budget review and rate filings. BCN Management Company's board of directors consists of four of the Company's board members, five board members from the HMO and one Company executive vice president.

Blue Care of Michigan (formerly Network Care dba Blue Care, Inc.)

Blue Care of Michigan was incorporated in July 1984, and is a wholly-owned subsidiary of the Company. Blue Care of Michigan has two wholly-owned subsidiaries: Michigan Health Care Education and Research Foundation and BCN Service Company. Blue Care of Michigan is an alternative health care and delivery system (AFDS) that has no medical liability risk, but does have risk associated with rating its products. Blue Care of Michigan offers certain individual, employer group, medical and dental care (Dental Care Network) products to its members through agreements with the Company. Blue Care of Michigan has a management services and real estate lease agreements with the Company. Blue Care of Michigan's wholly-owned Michigan Health Care Education and Research Foundation is a not-for-profit organization engaged in health care research and the Caring for Children program. Michigan Health Care Education and Research Foundation has an agreement with the Company covering certain administrative costs related to the Caring for Children program. Blue Care of Michigan's BCN Service Company is a not-for-profit corporation licensed as a Third Party Administrator for various managed care programs.

BCN of Michigan (formerly BCN of Southeast Michigan)

BCN of Michigan (formerly BCN of Southeast Michigan) is a wholly-owned subsidiary of the Company which was formed on January 1, 1998 through the merger and consolidation of the Company's three other regional HMO's (BCN of East Michigan, BCN of Mid Michigan, and BCN – Great Lakes). BCN of Michigan is a not-for-profit HMO operating throughout the state of Michigan and is located in Southfield, Michigan. BCN of Michigan has management service, administrative service and lease agreements with the Company.

Health First, Inc.

Health First, Inc. is 50 percent owned by the Company and was formed in 1986 as a for profit corporation. Borgess Health Alliance, an affiliate of Borgess Hospital located in Kalamazoo, Michigan owns the remaining 50 percent interest. Health First's stated purpose is to facilitate

contracts between certain hospitals and BCN of Michigan. Health First has an administrative services agreement with BCN of Michigan.

Global Health Options LLC

Global Health Options LLC (GHO) is 75 percent owned by the Company and was formed in 1995. GHO provides integrated health management programs to support the Company's core products.

Self Insured Trusts

The Company has formed two self insured trusts which replaced coverage provided by two now dissolved subsidiaries, Central Insurance Limited and Business Group Insurance.

Blue Care Network Malpractice Self Insurance Trust provides medical malpractice coverage for the Company and Blue Care of Michigan. No voting securities exist and the Company and Blue Care of Michigan are grantors of the trust. The trust is administered by a representative committee.

Blue Care Network Stop Loss and Casualty Self-Insurance Trust provides various stop loss and casualty coverage for the Company, Network Care and the Michigan Health Care Education and Research Foundation, which are also grantors of the trust. No voting securities exist. The trust is administered by a representative committee.

The Accident Fund of Michigan

In 1994, the Company acquired 100 percent ownership of the Accident Fund of Michigan, now a wholly-owned subsidiary of the Company and the largest workers' compensation carrier in Michigan.

PPOM, LLC

In 1997, the Company acquired interest in TPG-PPOM, Inc., PPOM GENPAR, Inc. and 100 percent of PPOM (Preferred Provider Organization of Michigan, L.P., a Delaware limited partnership). These Company's were consolidated by liquidating GENPAR and merging PPOM into a new limited liability company know as PPOM, LLC. PPOM, LLC is an independent preferred provider organization that has created a network of physicians, hospitals and other health care providers with the goal of offering affordable health care services.

Board of Directors

The restated Articles of Incorporation provide that the board of directors of the Company shall be persons named in accordance with the plan of consolidation and the bylaws of the Company, as amended. The membership of the Company's board of directors shall consist of 35 voting members in four components as required by Articles I and II of the bylaws. Regular meetings of the board of directors shall be held not more frequently than monthly, or less frequently than quarterly in accordance with the bylaws. Pursuant to Article I of the bylaws; the board of directors may exercise all of the powers of the corporation, and, by appropriate action may provide for any matter in the regulation and management of the affairs of the corporation not inconsistent with the bylaws, the Articles of Incorporation or any law, and any such action of the board, if properly taken, shall be binding upon the corporation, its directors, officers, agents and employees. Except as otherwise provided in the bylaws, or in the plan of restructuring, a director shall serve for a term of two years, more or less, and until a

successor is selected and qualified or until resignation or removal. The term of the corporate management director shall be concurrent with the term as chief executive officer.

The board of directors duly elected or appointed and serving as of September 30, 2000 were:

Jon E. Barfield	Charles L. Burkett
Ruben Burks	J. Barry Sloat
Gerson I. Cooper	Barbara Dumouchelle
John W. Copeland	Frank Garrison
Lorene H. Fisher, RN	Lila R. Johnson
Charles M. Gayney	John M. MacKeigan, MD
Fred J. Johns	A. Barry McGuire
Spencer C. Johnson	Lewin Wyatt, Jr., DO
Gary J. McInerney	Maureen P. Reilly
James W. Richards, R.PH	Wallace D. Riley
Joan C. Rodney	Edgar A. Scribner
Krishna K. Sawhney, MD	Richard Shoemaker
Kathleen B. Shapiro	Donald E. Stroud, DDS
Gregory A. Studderth	Iris K. Salters
Richard E. Whitmer	Roy A. Westran
Stephen P. Yokich	James W. Woodruff, Ed.D

Committees

Pursuant to Article V of the bylaws, the board of directors may establish any committee it considers necessary to perform its duties. In addition to board of directors committees, there are a number of joint committees which consist of board members, senior management and providers.

As of September 30, 2000, the board of directors had established the following committees: Ad Hoc Nominating Committee, Executive Committee, Finance Committee, Audit Committee, Credentials Committee, Provider Relations Committee, Health Care and Delivery Committee and the Pension Advisory Committee. As of September 30, 2000, the following joint committees were established: Participating Hospital Advisory Committee, Reimbursement Committee, Budget Review Committee/Appeal Panel and the Physician and Professional Provider Contract Advisory Committee.

Officers

Pursuant to Article VI of the bylaws; the board of directors shall elect a chief executive officer who shall serve as chairperson of the board unless the board, by a vote of not less than a majority of its members then in office, acts to select another director as chairperson. The board of directors shall also select a vice chairperson. The board of directors may select such other officers or assistants as nominated by the chairperson.

The officers of the Company at September 30, 2000 were:

Name	Title
Charles Burkett	Chairman of the Board
Lorene H. Fisher, RN	Vice Chairman of the Board
Richard E. Whitmer	President and Chief Executive Officer
Robert H. Naftaly	Executive Vice President

J. Paul Austin	Senior Vice President, Michigan Sales and Service
George F. Francis, III	Senior Vice President and Chief Administrative Officer
Steven C. Hess	Senior Vice President, General Counsel and Corporate Secretary
Raymond R. Khan	Senior Vice President and Chief Information Officer
James C. Epolito	Senior Vice President, Subsidiary Operations
David B. Siegel, MD	Senior Vice President, Health Care Management Division
Marianne Udow	Senior Vice President, Health Care Products and Provider Services
Leslie A. Viegass	Senior Vice President, Auto National Services
Mark R. Bartlett	Senior Vice President and Chief Financial Officer
Richard T. Cole	Senior Vice President, Corporate Communications
Brenda L. Ball	Vice President and Treasurer

PLAN OF OPERATION

Subscribers

Subscribers are those individuals and groups who subscribe to the Company for health insurance coverage. The Company offers both underwritten coverages and administrative service contracts as well as HMO coverage through its Blue Care HMO Network, preferred provider organization (PPO) and point of service managed care options.

The underwritten market segment includes both groups and individuals in the following categories: Experience Rated, Area and Industry Rated, Group Conversion, Non-Group and Other-than-Group Complementary.

Experience rated includes those employer groups whose rates are based on the "experience" or total use of health care benefits by the group's members during a coverage period. Usually, the coverage period is one year. Underwritten groups of 100 or more members must be experienced rated. The Company has three different experience rated formulas with different options depending on the size of a given group. The experience rated underwritten segment make up approximately 17 percent of the Company's total subscriber income.

Area rated are groups of less than 100 contracts in one of six defined geographic areas in Michigan whose rates are based on their total use of benefits. Underwritten groups of 99 or fewer contracts must be area rated. The area rated underwritten segment makes up approximately 24 percent of the Company's total subscriber income.

Group conversion includes those individuals who terminate their coverage with an organization having the Company's group health coverage, but are entitled to continue as subscribers by paying for their own coverage at special rates. The group conversion underwritten segment makes up approximately 1 percent of the Company's total subscriber income.

Non-group consists of individual subscribers who pay for their own coverage. The non-group underwritten segment accounts for approximately 1 percent of the Company's total subscriber income.

Other-than-group complementary are individual subscribers who purchase Medigap coverage which supplements medicare benefits. The other-than-group complementary underwritten segment represents approximately 2 percent of the Company's total subscriber income.

Administrative service contract segment consists of groups who underwrite their own health care coverage, but contract with the Company to supply various administrative services such as processing claims. The Administrative Service Contract segment is subdivided into the auto, national and local customer segments with the auto segment being the largest customer segment. The administrative service contract segment accounts for approximately 52 percent of the Company's total subscriber income.

The Company also participates with other states' Blue Cross and Blue Shield plans in providing coverage to either Michigan based companies with employees residing in other states or a company based in another state with employees residing in Michigan. The business is referred to as "national business" and the coverage provided can either be on underwritten or administrative services only basis.

Providers

Providers are those organizations that provide health care services to the Company's subscribers. The Company contracts with participating hospitals, physicians, specialists, pharmacies and other health care organizations. The Company has 185 participating hospitals.

The Company processes provider claims on seven main claims systems: Blue Cross (mostly hospital facility related claims), Blue Shield (physician/specialist), drugs (pharmacies), vision and hearing, master/major medical and Federal Employee Program. Through September 30, 2000, the Blue Cross (also known as the Facility) claims system processed the greatest dollar volume of claims. The Company also participates in a consortium of other Blue Cross and Blue Shield plans in the National Account Service Company (NASCO). NASCO provides data processing services which support processing claims, generate claim payments and provide reports for certain accounting services.

GROWTH OF THE COMPANY

Year	Admitted Assets	Liabilities	Statutory Reserves	Net Income
December 31, 1997 *	$ 3,005,480,724	$ 1,981,659,666	$ 1,023,821,058	$ 45,368,540
December 31, 1998	3,214,218,408	2,102,428,451	1,111,789,957	83,396,188
December 31, 1999	3,473,274,495	2,359,193,025	1,114,081,470	89,061,513
September 30, 2000 *	3,594,060,393	2,433,260,893	1,160,799,500	33,490,165

*Per Report of Examination

REINSURANCE

The Company reinsures 100 percent of its risk covering the non-group and group conversion market segment for organ transplants with BCS Insurance Company. The maximum amount of reinsurance is $2,000,000 per transplant recipient's lifetime. BCS Insurance Company pays the Company a provisional ceding commission on business ceded. BCS Insurance Company is an authorized insurer in the state of Michigan.

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
BALANCE SHEET
As of September 30, 2000

Assets

Bonds	$ 722,934,868
Preferred stocks	43,887
Common stocks	570,349,688
Real estate	208,998,611
Cash and short-term investments	(12,414,194)
Other invested assets	202,071,403
Uncollected premiums	80,810,994
Electronic data processing equipment	26,306,902
Interest and other investment income due and accrued	9,191,387
Receivable from parent, subsidiaries and affiliates	56,173,211
Advances to providers	308,526,416
Offsetting premium receivable - reimbursement accounts	559,545,351
Deferred tax asset	6,833,314
Miscellaneous accounts receivable	36,106,401
Equipment, furniture and supplies	13,169,484
Computer software capitalization	80,263,895
Bank overdrafts reclassified as liabilities	113,606,879
Benefit plan related assets	1,978,387
Securities lending collateral receivable	156,634,593
Prepaids and other assets	1,290,526
Amounts due from ASC groups	69,758,530
Accounts receivable from other plans	6,605,403
Rate stabilization receivable (net)	375,274,457
Total assets	$ 3,594,060,393

Liabilities, Reserves and Other Funds

Claims unpaid	$ 1,159,005,612
Unpaid claims adjustment expenses	74,292,260
Unearned premiums	151,687,392
Taxes, licenses and fees	1,798,649
Other expenses due or accrued	104,005,407
Amounts withheld or retained for account of others	8,119,176
Provision for experience rating refunds	157,334,900
Bank overdrafts	113,606,880
Advances from providers	262,887,563
Securities lending collateral payable	156,634,593
Pension and other postretirement liabilities	232,565,675
Liability for uncashed checks	10,027,952
Federal income taxes	1,294,834
Total liabilities	$ 2,433,260,893
Statutory reserve	910,977,456
Managed care division accumulated funds	70,464,182
Accident fund accumulated funds	174,578,864
Preferred providers of Michigan accumulated funds	5,829,998

GHO accumulated funds	(1,051,000)
Total reserves	$ 1,160,799,500
Total liabilities and reserves	$ 3,594,060,393

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
UNDERWRITING AND INVESTMENT EXHIBIT

For the Period Ending September 30, 2000

Underwriting Income		
Premiums earned		$ 6,666,917,931
Claims incurred		6,123,054,194
Expenses incurred:		
Claims adjustment		188,216,963
Administrative		196,280,443
Soliciting		196,857,037
	Total underwriting deductions	6,704,408,637
	Net underwriting loss	$ (37,490,706)
Investment Income		
Net investment income earned		$ 82,756,399
Realized capital losses		(1,587,462)
	Net investment gain	$ 81,168,937
Other income		
Loss from managed care divisions		$ (12,204,658)
Loss from accident fund company		(4,997,000)
Loss from preferred providers of Michigan		(503,665)
Miscellaneous income		7,699,895
	Net gain before federal income taxes	33,672,803
Federal income taxes incurred		(182,638)
	Net gain	$ 33,490,165
Reserves and Unassigned Funds		
Reserves at December 31, 1999		$ 1,114,081,470
Gains and (Losses)		
Net gain		33,490,165
Unrealized gain on investments		36,827,865
Examination adjustments		(23,600,000)
	Reserves at September 30, 2000	$ 1,160,799,500

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
CASH FLOW STATEMENT

For the Period Ending September 30, 2000

Premiums collected net of reinsurance	$ 6,542,473,761
Claims and claims adjustment expenses	6,288,518,464
Underwriting expenses paid	330,671,963
Cash used for underwriting	(76,716,666)
Net investment income	40,211,709
Other income (expenses)	(19,150,767)
Federal income taxes (paid) recovered	17,447,073
Net used for operations	(38,208,651)
Proceeds from investments sold, matured or repaid:	
Bonds	776,897,356
Stocks	18,664,757
Real estate	26,432
Other invested assets	11,526,243
Total investment proceeds	807,114,788
Cost of investments acquired (long-term only):	
Bonds	846,561,445
Stocks	19,661,584
Real estate	6,852,943
Other invested assets	20,012,727
Total investment acquisitions	893,088,699
Net cash used for investing	(85,973,911)
Cash from financing and miscellaneous sources - net transfers from affiliates	53,000,000
Net change in cash and short-term investments	(71,182,562)
Cash and short-term investments, December 31, 1999	58,768,368
Cash and short-term investments, September 30, 2000	$ (12,414,194)

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
EXAMINATION ADJUSTMENTS

For the Period Ending September 30, 2000

Total reserves, per Company, as of September 30, 2000			$ 1,184,399,500
	Balance Per Company	**Balance Per Examination**	**Increase (Decrease) in Net Worth**
Rate stabilization receivable (net)	398,874,457	375,274,457	$ (23,600,000)
Total examination adjustments			$ (23,600,000)
Total reserves, per examination, as of September 30, 2000			$ 1,160,799,500

BLUE CROSS AND BLUE SHIELD OF MICHIGAN
NOTES TO FINANCIAL STATEMENTS
As of September 30, 2000

1. Significant Accounting Policies

The Company is incorporated as a nonprofit corporation under the provisions of Michigan Public Act 350 (the "Act"). Hospital, medical and other health benefits are provided under contracts with subscribers. The corporation also operates a health maintenance organization ("HMO") subsidiary that provides health care services to subscribers or contracts with various physician groups, hospitals and other health care providers to provide such services.

2. Short-term Investments

Short-term investments are carried at cost, which approximates fair market value.

3. Investments in Debt and Equity Securities

During 1994, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 115, "Accounting for Certain Investments in Debt and Equity Securities." The Company has classified its debt securities as available-for-sale; accordingly, its debt and equity securities are carried at market value on page 2 of the annual statement. The unrealized gains and losses related to these securities are excluded from earnings and reported as a separate component of reserves and unassigned funds, net of related deferred income taxes.

4. Investment in Subsidiaries

Investments in subsidiaries are reported on the net worth basis.

5. Property and Equipment

Property and equipment is stated at cost and is depreciated by the straight-line method over estimated useful lives ranging from 30 to 40 years for buildings and 5 to 10 years for equipment.

6. Software Costs

Certain costs related to acquired and developed computer software for internal use are capitalized as incurred in accordance with Statement of Position ("SOP") 98-1, "Accounting for the Costs of Computer Software." Capitalized costs are amortized using the straight-line method generally over a five year useful life.

7. Investment Income

Realized gains and losses on sales of securities are determined based on specific identification method and included in investment income.

8. Rate Stabilization Recoverable

Certain expenses under its area rated block of business have been capitalized as incurred in accordance with SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation." Capitalized expenses are reduced as future profits are generated on this book of business. As of September 30, 2000, the Company has not recouped any previously capitalized expenses.

9. Retirement Income Plans

The Company has defined benefit retirement income plans covering substantially all employees twenty-one years or older having one year or more of continuous services. The Company's policy is to fund accrued retirement costs to the extent permitted by Internal Revenue Service regulations as determined by consulting actuaries. Substantially all employees who meet certain requirements of age and length of service are covered by the Company's two noncontributory, defined benefit retirement income plans. Benefits paid to retirees are based on age at retirement, years of credited service and highest monthly earnings over sixty consecutive months.

The following table sets forth the funded status of the two plans and accrued pension expense at September 30, 2000:

Actuarial present value of benefit obligations:	
Vested benefits	$ 453,970,471
Nonvested benefits	27,448,984
Accumulated benefit obligations	481,419,455
Effect of projected future pay increases	45,123,251
Projected benefit obligations	526,542,706
Plan assets at fair market value	$ 745,838,630
Plan assets in excess of projected benefit obligation	$ 219,295,924
Unrecognized net assets at January 1, 1987 (amortized over 15 years)	(1,570,589)
Unrecognized service cost	126,658
Unrecognized net gains from experience different from that assumed	(223,346,796)
Additional benefits between measurement date and fiscal year end	(237,572)
Accrued pension expense included in other expenses	$ (5,732,375)

The discount rate used in determining the actuarial present value of the projected benefit obligation was 7.75 percent at September 30, 2000. Assumed rates of increase in future compensation range from 5.53 to 2.98 percent at September 30, 2000, depending on the ages of the participants. The expected long-term rate of returns on assets was 9.5 percent at September 30, 2000.

Net periodic pension benefit consists of the following for the period ended September 30, 2000:

Service cost	$ 17,991,988
Interest cost on projected benefit obligation	38,953,860
Expected return on plan assets	(58,920,140)
Net amortization and deferral	(4,650,129)
Net periodic pension benefit	$ (6,624,421)

10. Postretirement Benefits Other than Pensions

The Company provides certain health care and selected other benefits to all employees and their dependents. Represented and nonrepresented employees who have ten years of service after age 45 and retire from active employment, or who become disabled and meet certain benefit and service requirement are eligible. This benefit is subject to revision at the discretion of the board of directors for nonrepresented employees and for represented employees, subject to collective bargaining agreements.

The Company's postretirement health care plan is noncontributory and unfunded. The accumulated obligation for employee postretirement benefits attributable to active and retired employees and the amount recognized in the Company's balance sheet as of September 30, 2000 is as follows:

Accumulated postretirement benefit obligation:	
Retirees and dependents	$ 102,491,477
Eligible active participants	55,182,186
Actives not yet eligible	67,787,923
Accrued postretirement obligation	225,461,586
Unrecognized prior service cost	13,231,757
Unrecognized accumulated net gain	(7,175,755)
Accrued post retirement benefit liability included in other expenses	$ 231,517,588

Net periodic postretirement benefit cost for the period ended September 30, 2000 includes the following components:

Service cost	$ 12,278,701
Interest cost	14,543,824
Net amortization and deferral	(4,519,690)
Net periodic postretirement benefit cost	$ 22,302,835

For the period ended September 30, 2000, the medical health care trend rate on covered benefits is assumed to be 6.02 percent in 2000, grading down uniformly to 4.0 percent by 2003 and all years thereafter. The prescription drug health care trend rate on covered benefits is assumed to be 9.81 percent in 2000 grading down uniformly. The discount rate used to discount future benefit payments is 7.75 percent, as of September 30, 2000.

11. Contingency Reserves

Under the provisions of the Act, the Company is required to maintain subscriber reserves at a target level established by the Commissioner of Financial and Insurance Services annually based on the aggregate of the Company's prior year benefits provided and operating expenses. At December 31, 1999, the target reserve was $743,814,977. Under provisions of the Act, the Company is required to maintain minimum reserves of 65 percent of the target reserve and may not exceed a maximum of 150 percent of the target reserve. If the Company's reserves exceed 150 percent of the target reserve or fall below 65 percent of the target reserve in a given year, the Company shall implement adjustments as necessary to bring the reserves below the 150 percent level or above the 65 percent level and shall file these adjustments with the Commissioner. If the Company's reserves exceed 150 percent or fall below 65 percent of the target reserve for two successive calendar years, then the Company is required to file a plan with the Commissioner to adjust the reserves within the required range.

EXAMINATION FINDINGS AND RECOMMENDATIONS

1. Area Rate Stabilization Receivable Recoverability

The Company has recorded a rate stabilization receivable (RSR) at September 30, 2000 of $398,874,457, net of a reserve of $72,235,756, which is associated with its administration of the area rated block of business. The Company has established the RSR balance utilizing guidance set forth in Statements of Financial Accounting Standards ("SFAS") No. 71 "Accounting for the Effects of Certain Types of Regulation." The underlying assumption under SFAS 71 is that if future rates of regulated entities include an increment for recoupment of previously incurred costs, the losses may be capitalized and reduced as additional income is received in future years.

The Company has prepared significant documentation and modeling of various assumptions used in estimating the recoverability of this amount. As part of the examination procedures, we reviewed the Company's actuarial analysis and modeling along with the Company's external actuary's analysis. Specific areas addressed in determining recoverability during our modeling focused on: 1) evaluating data and reviewing trend factors, 2) assessing the impacts of anti-selection, 3) assessing investment income effects, 4) addressing surcharge valuation and 5) reviewing rating constraints inherent within the prescribed rate-making formula. Our final analysis concurred with the Company's analysis on several key recoverability calculation inputs. However, we were not in complete agreement with the Company's assumptions and conclusions, but recognize that a range of reasonable results exists when a complex calculation is evaluated.

Our analysis of the RSR asset resulted in a range of recoverable amounts from approximately $325 million to $425 million, the mid-point of the range being $375 million (as shown in the accompanying examination report.) The breadth of the range reflects the uncertainty of future events being predictable solely from historical data and acknowledge that the Company’s estimate falls within a reasonable range.

Based upon our examination procedures and actuarial analysis, we have estimated approximately $375,274,457 of the RSR balance recorded at September 30, 2000 appears to be recoverable over the next five years and as a result we are reflecting a $23.6 million adjustment in our reported balance sheet. However, given that the Company is sufficiently within the range derived by our actuarial analysis, no adjustment is required of financial information filed as of September 30, 2000 and December 31, 2000. We recommend the Company use the more conservative estimate of collectibility of the RSR balance in future periods. The Company should continue to monitor potential impairment of this regulatory asset in accordance with SFAS 121 and record such impairment, if any, in periods subsequent to December 31, 2000.

CONCLUSION

This examination, as of September 30, 2000, disclosed the Company to have total assets of $3,594,060,393, liabilities of $2,433,260,893 and reserves of $1,160,799,500.

Appreciation is expressed for the cooperation and assistance extended by the officers and employees of the Company.

In addition to the undersigned, PricewaterhouseCoopers LLP participated in this examination. Key PricewaterhouseCoopers LLP staff that participated in this examination included Denise Essenberg, Partner; Mark Woudstra, Senior Manager; Teisha Thomas, Senior Manager; and Martin Staehlin, FSA, MAA, Actuary.

Respectfully submitted,

Steve Honsowetz, CFE
Examiner-in-Charge
Office of Financial and Insurance Services

EXHIBIT 1

STATEMENT OF ACTUARIAL OPINION

Quarterly Statement of Blue Cross Blue Shield of Michigan
For the Quarter Ending September 30, 2000

I, Martin E. Staehlin, Consulting Actuary, am associated with the firm of PricewaterhouseCoopers LLP (PwC), Certified Public Accountants, and am a member of the American Academy of Actuaries. I have been involved in the examination of accident and health claim reserves and certain other actuarial items of Blue Cross Blue Shield of Michigan (the Company) for the quarter ended September 30, 2000.

I have examined the actuarial assumptions and actuarial methods used in determining the actuarial assets and liabilities indicated below, including claims unpaid, as shown in the Quarterly Statement as of September 30, 2000.

Advances to Providers	(Assets Line 1901)	$308,526,416
Offsetting Premium Receivable Reimbursement Accts.	(Assets Line 1902)	$559,545,351
Claims Unpaid	(Liabilities, Line 1)	$1,159,005,612
Unpaid Claims Adjustment Expense	(Liabilities, Line 3)	$74,292,260
Provision for Experience Rating Refunds	(Liabilities, Line 1401)	$157,334,900
Advances to Providers	(Liabilities, Line 1404)	$262,887,563
Pension and Other Postretirement Liabilities	(Liabilities, Line 1406)	$232,565,675

In making my examination, I have relied upon relevant data prepared under the direction of John Dunn, Director and Corporate Actuary. I performed no verification as to the accuracy and completeness of this data. Additionally, I have not examined the Company assets. In other respects, my examination included such review of the actuarial assumptions and actuarial methods and such tests of the actuarial calculations as I considered necessary.

In my opinion, the reserves for unpaid claim liabilities and related actuarial items listed above:

- Are computed in accordance with commonly accepted actuarial standards consistently applied and are fairly stated in accordance with sound actuarial principles;

- Are based on actuarial assumptions which produce reserves at least as great as those called for in any policy or contract provision as to reserve basis and method and are in accordance with all other policy or contract provisions;

- Meet the requirements of the insurance laws of the State of Michigan;

- Make good and sufficient provision in the aggregate for all unmatured obligations of the Company guaranteed under the terms of its policies, based on actuarial assumptions as to future contingencies which I deem to be reasonable and appropriate under the circumstances;

- Are computed using methods and assumptions which are consistent with those used to prepare the estimates of these same actuarial items in the Annual Statement as of December 31, 1999; and

- Include provision for all actuarial reserves and related actuarial statement items, which ought to be established.

Actuarial methods, considerations, and analyses used in forming my opinion conform to the appropriate Standards of Practice as promulgated from time to time by the Actuarial Standards Board, which standards form the basis of this statement of opinion.

In addition to the items listed above, I have examined the actuarial assumptions and actuarial methods used in determining the rate stabilization reserve (RSR), both gross and offset listed below, as adjusted as of September 30, 2000.

Rate Stabilization Reserve Gross	(Assets, Line 1913)	$ 471,110,213
Rate Stabilization Reserve Offset	(Assets, Line 1914)	$ (95,835,756)

In making my examination, I have relied upon relevant data prepared by John Dunn, Director and Corporate Actuary as well as supporting actuarial analyses prepared under the direction of Brian Morris, Director and Chief Pricing Actuary.

In my opinion, the rate stabilization reserves, netted together:

- Are computed in accordance with sound actuarial principles and use actuarial assumptions and methods that produce a best estimate of recoverable balances;

- Are computed using methods and assumptions which are consistent with those used to prepare the estimates of these same actuarial items in the Annual Statement as of December 31, 1999;

- Include provision for all potential impacts on the RSR balance using information known today.

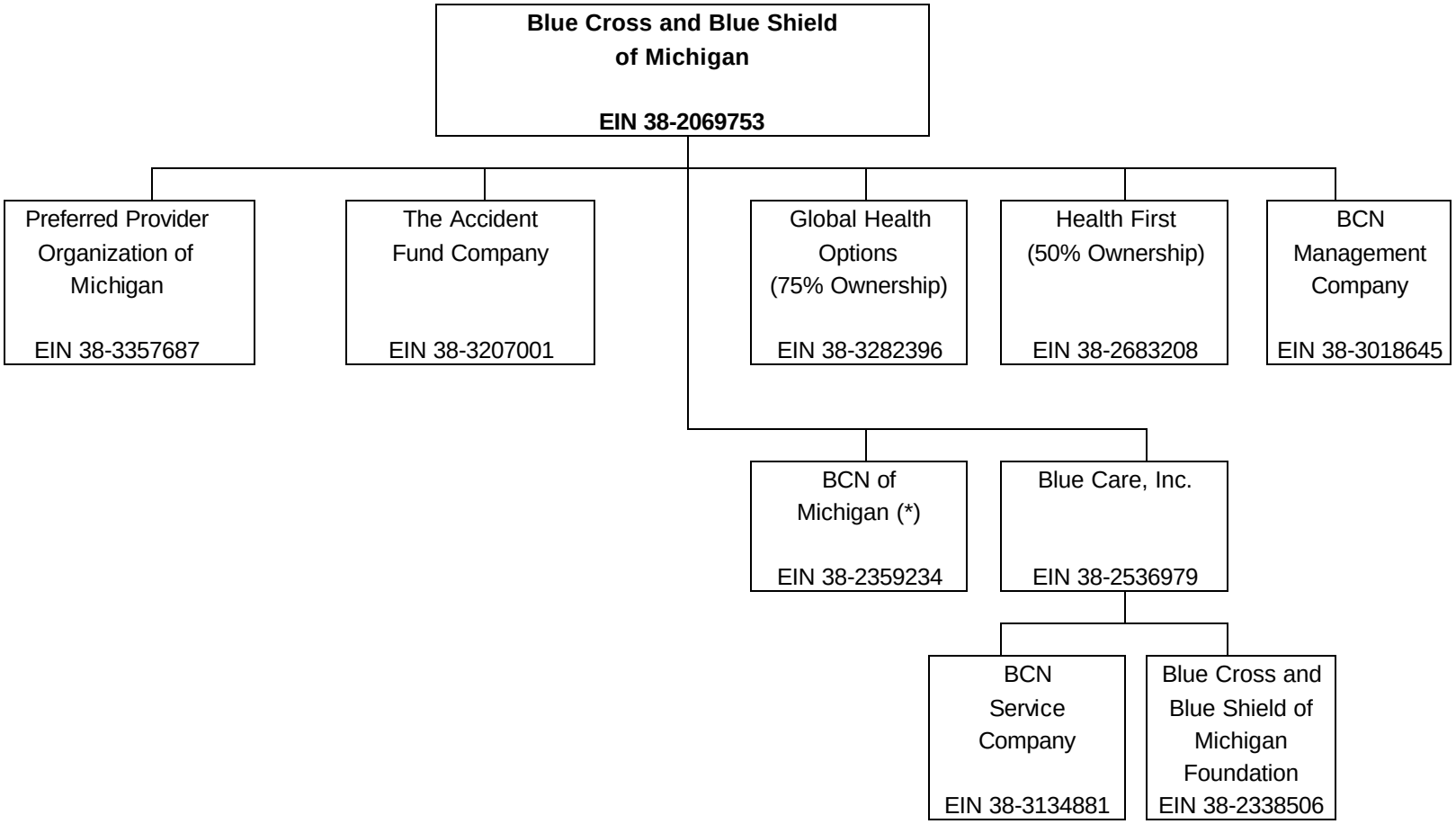
The purpose of this review is to provide the state with an independent actuarial opinion and is provided every three years. Since the prior independent review, the magnitude of the RSR balance has increased significantly. The analysis of the RSR balance is, in substance, an actuarial valuation. This valuation was based upon generally accepted actuarial methods. We performed such tests as we considered necessary to ensure the accuracy of the results. We certify that the amounts presented in the referenced quarterly statement have been determined appropriately according to the actuarial assumptions and methods that we reviewed and tested. It should be recognized, however, that because future events frequently do not occur exactly as expected, there are usually differences between projected and actual results. Accordingly, there can be no assurance that actual experience will match our projections.

This opinion is updated in conjunction with the examination of the Company by the State of Michigan Office of Financial and Insurance, Services. To the best of my knowledge, there have been no material changes from the quarterly statement documented in this opinion and the year-end financial statements immediately following this quarter.

Martin E. Staehlin, FSA, MAAA
April 30, 2001
(For a signed copy, please contact OFIS).

c/o PricewaterhouseCoopers LLP (Corporate address)
203 North LaSalle Street
Chicago, IL 60601
(312) 701-5709 (Corporate phone number)

EXHIBIT 2



* Entity resulting from the consolidation of BCN of East Michigan, BCN - Great Lakes, and BCN of Mid Michigan.